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No. 91-181

Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

AGRO SCIENCE CO. AND BAVARO INVESTMENT CO.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

R & D PARTNERS-82 AND DONALD D. SPEAR,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ALFA MEDICAL RESEARCH ASSOCIATES AND MARC GELLER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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PETITIONER'S REPLY TO BRIEF IN OPPOSITION

1. **The Circuits are in conflict on profit motive.** Respondent misstates our position. We do not argue that profit motive should be determined at the partner level (Resp. Br. p. 8-9). Profit motive is determined at the partnership level, but based on the motive of each separate partnership. The test of motive requires us to take "into account all of the facts and circumstances of each case." Treas. Reg. § 1-183-2(a). That didn't happen here.

The Tax Court recently recognized that in this case the Fifth Circuit established a different rule: that every Coral partnership "lacked a profit objective when they had the primary intent of realizing tax advantages." Universal Research & Development Partnership #1, et al. v. Comm'r, T.C. Memo 1991-437.[1] This is the wrong standard. Other Circuits

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[1]This case found profit motive in an 8-1 research project denominated in Brazilian cruzeiros.

require an "actual and honest profit objective." Rose v. Comm'r, 868 F.2d 851, 853 (6th Cir. 1989). Each Coral partnership evidenced different profit objectives even though all partnerships may have sought significant tax advantage. One hundred partnerships may not be tarred with the same brush.

Respondent claims support from the Tax Court decision in Smith v. Comm'r, 91 T.C. 733 (1988) (Resp. Br. p. 8). However, that case was reversed in the Sixth Circuit. 937 F.2d 1089 (6th Cir. 1991), rev'g 91 T.C. 733. Remarkably, the same decision was affirmed in the Eleventh Circuit (Karr v. Comm'r, 924 F.2d 1018 (11th Cir. 1991) aff'g 91 T.C. 733). There is a conflict in the Circuits on the proper test for profit motive.

2. **Missing the point on accrual:** Respondent concludes from the findings below that the "Research Notes" would be "virtually

worthless" at the time payment became due (Rep. Br. p.3). His timing is off. The obligor must accrue the obligation when it becomes fixed, not as of the potential payment date. That is exactly why this Court approved accrual of jackpots even though it was unknown and unknowable as to when those amounts (without interest) would actually be paid. United States v. Hughes Properties, Inc., 476 U.S. 593 (1986). But, even if "present value" were relevant, "virtual worthlessness" is not "worthless." Even under the new law some accrual would be allowed.

Congress' enactment of § 989(c)(3), I.R.C. (1986) dealt specifically with hyperinflationary currency. Congress decided that such obligations are not ipso facto without economic substance. Under § 989(c)(3), the present value of that obligation discounted by the appropriate foreign interest rate would be deductible.

3. **The bona fides of research cannot be ignored:** Respondent chooses to disregard the Tax Court's rejection of the bona fides of taxpayer's research theory (Resp. Br. p. 9, fn. 4) because the Fifth Circuit did not rely on that finding. However, to apply the "for profit" test, it is necessary to determine "whether the transaction has any practical effects other than the creation of income tax losses." Rose v. Comm'r, 868 F.2d at 853.

> It is crucial moreover that this inquiry be conducted from the vantage point of the taxpayer at the time the transaction occurred rather than with the benefit of hindsight.

Smith v. Comm'r, 937 F.2d at 1096.

The conflict should be corrected.

Respectfully submitted,

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